

RULES OF THE  
DEPARTMENT OF REVENUE

CHAPTER 810-3-6

Gain or Loss - Basis of Property; Adjusted Basis

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810-3-6-.01. Basis in Property.

(1) For the purposes of Chapter 6 of these regulations, the following definitions apply:

(a) Unadjusted basis in property - The original cost of the property if acquired after January 1, 1933. If the property was acquired prior to January 1, 1933 the unadjusted basis is the fair market value on January 1, 1933.

(b) Adjusted basis in property (for transactions before January 1, 1985) - The unadjusted basis in the property, plus the cost of improvements of a permanent character made to the property that have been properly classified as a capital expenditure, minus prior return of investment, depreciation, amortization, depletion, and other reductions in the original cost.

(c) Fair market value - The price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each having knowledge of all relevant facts.

1. The determination of the fair market value of property is generally a question of fact and shall be established by competent evidence. The general way of determining the fair market value of stock, in the absence of knowledge of sales on any given date, is to value the stock on the basis of the corporate assets underlying the stock as disclosed by a balance sheet as of this date.

(2) The general rule is that the unadjusted basis of property is its cost. The term "adjusted basis" means, in substance, the original capital investment ("unadjusted basis") adjusted to the date the taxpayer disposes of the property. "Basis" for determining gain or loss on sale or other disposition is also the "basis" for computing depreciation, and in some cases, depletion.

(a) The adjusted basis for determining the gain or loss from the sale or other disposition of property is the basis of the property defined in §40-18-6(a), Code of Alabama 1975, adjusted to the extent provided in §40-18-6(b)(1) as in effect prior to January 1, 1985, or adjusted to the extent provided in §40-18-6(b) as in effect after December 31, 1984; and interpreted below:

1. Expenditures made by the taxpayer after acquisition of a property for improvements, additions or betterments of a relatively permanent character, such as to prolong the life or increase the utility of the property in substantial degree beyond the life or utility reasonably to be expected from properties of like age and character, shall be added to and increase the original basis of such property for the purpose of determining gain or loss upon the disposition thereof. No adjustment shall be made in respect of any item which, under any applicable provision of law or regulation, is treated as an item not properly chargeable to a

capital account but is allowable as an expense deduction in computing net income for the taxable year.

2. Adjustments to basis may be made for carrying charges such as taxes and interest, with respect to unimproved and unproductive real property, if the taxpayer elects to treat these items as chargeable to asset accounts rather than as an allowable expense deduction. The term "taxes" for this purpose includes duties and excise taxes but does not include income taxes.

3. In any case in which a portion of the taxpayer's cost or investment has been returned to him in any form or manner since acquisition, or any losses have been incurred, or other items or events have transpired, resulting in a return of capital, the amount thereof shall apply against and reduce the original basis to the taxpayer. Thus, any receipts or credits arising from or related to the ownership of an item of property, which receipts or credits do not constitute income taxable under the law, are to be treated as a refund of a portion of the original cost.

(3) If a casualty loss has been sustained, the cost basis in the property must be reduced by the amount of the casualty loss claimed as a deduction in the computation of net income. If the loss is reimbursed, in part or total, by insurance proceeds; the insurance proceeds must be used to repair the property to its original state. For losses occurring in tax years ending before January 1, 1985, if the insurance proceeds are not used to repair the property to its original state, the casualty must be treated as an involuntary conversion and any gain recognized and reported as income. See Reg. 810-3-8-.06 for involuntary conversions. For losses in tax years beginning after December 31, 1984, see Reg. 810-3-8-.06(2) for determination of recognizable gain, if any.

(a) EXAMPLE: A rental dwelling was partially destroyed by fire. The fair market value of the property immediately before the fire was \$20,000.00 (\$2,000.00 for the land and \$18,000.00 for the dwelling). The fair market value just after the fire was \$12,000.00 (\$2,000.00 for the land and \$10,000.00 for the dwelling). The insurance reimbursement was \$5,000.00. The entire amount of the insurance proceeds were used to repair the property to its original state. Taxpayers adjusted cost basis in the property before the casualty was \$6,000.00 (\$1,000.00 for the land and \$5,000.00 for the dwelling). The adjusted basis in the property following the casualty is as follows:

	<u>Land</u>	<u>Building</u>
a. Cost/basis	\$ 1,000	\$ 5,000
b. Fair market value before	2,000	18,000
c. Fair market value after	2,000	10,000
d. Change in fair market value	0	8,000
e. Smaller of cost or change in market value	0	5,000

f. Less insurance proceeds	0	5,000
g. Casualty loss (e - f)	0	<u>0</u>
h. New adjusted basis before repairs	<u>\$ 1,000</u>	<u>0</u>

(b) EXAMPLE: Same facts as in example (3)(a) above, except the dwelling is a personal residence. The casualty loss and adjusted basis would be computed as follows:

	<u>Homesite</u>
a. Cost/basis	\$ 6,000
b. Fair market value before	20,000
c. Fair market value after	12,000
d. Change in market value	8,000
e. Smaller of cost or change in market value	6,000
f. Less insurance proceeds	5,000
g. Casualty loss (e - f)	<u>\$ 1,000</u>
h. New adjusted basis before repairs	<u>0</u>

(4) The original basis must also be decreased by the amount of maximum allowable deductions for exhaustion, wear and tear, obsolescence (these three items hereinafter referred to as "depreciation"), amortization, and depletion under the law applicable to the periods of time prior to January 1, 1935 and subsequent to January 1, 1935. Deductions allowable shall reduce the original basis of the property to the adjusted basis for determining gain or loss. These deductions shall be the greater of the following two amounts:

(a) the amount allowed as deductions in computing taxable income to the extent resulting in a taxpayer's income taxes, or

(b) the amount allowable for the years involved.

(c) The general rule is "Always in the amount allowed, but never less than the amount allowable."

(d) It is not necessary for this depreciation, amortization, or depletion to have been claimed on tax returns or entered in taxpayer's records. It shall be assumed that the taxpayer has claimed maximum allowable deductions regardless of the expiration of the statutory period for claiming deductions. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any such allowance or his taking an allowance plainly inadequate under the known facts in prior years. In the case of depreciation, if in prior years the

taxpayer has consistently taken proper deductions under one method, the amount allowable for such prior years shall not be increased even though a greater amount would have been allowable under another proper method.

(5) In the case of stock, the original basis must be decreased by the amount of distributions previously made which at the date of distribution were either tax free or applicable in the reduction of basis. This does not apply to exempt dividends paid from income earned since January 1, 1933, by the corporations paying the dividend.

(6) For transactions occurring in a tax year beginning before January 1, 1985, whenever it appears that the basis of property of the taxpayer is a substituted basis, then the adjustments provided in §40-18-6(b) and this regulation shall be made after first making, in respect to such substituted basis, proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person from whom the basis is to be determined. A similar rule shall be applied in case of a series of substituted bases.

Author: Roy Wiggins  
Authority: §40-18-6, Code of Alabama 1975  
History: Effective September 30, 1982.  
Effective August 30, 1988.  
Amended September 18, 1996, effective October 23, 1996.

810-3-6-.02 Basis for Computing Gain or Loss - Exceptions.

(1) The basis of property shall be the cost of the property with the following exceptions:

(a) Inventory - If the property should have been included in the last inventory, the basis shall be the amount used in the last inventory.

(b) Gifts or Transfer in Trust - See Rule 810-3-6-.04.

(c) Property Transmitted at Death - See Rule 810-3-6-.05.

(d) Property Acquired Upon Like-Kind Exchange - See Rule 810-3-06.

(e) Transfers to a Corporation - See Rule 810-3-6-.07.

(f) Property Acquired on Liquidation of a Subsidiary - See Rule 810-3-6-.08.

(g) Basis of Property of Subsidiary After Acquisition - See Rule 810-3-6-.09.

(h) Basis of Property Received in Liquidation in which a Gain or Loss was Recognized- See Rule 810-3-6-.10.

(i) Basis of Stock after a Stock Dividend - See Rule 810-3-6-.11.

(j) Involuntary Conversion - See Rule 810-3-6-.12.

(k) Property Acquired Before January 1, 1933 - See Rule 810-3-6-.13.

(l) Property Acquired from a Spouse or Former Spouse - See Rule 810-3-6-.14.

(m) Basis of Replacement Property in Sale of Stock to ESOP or Cooperative - See Rule 810-3-6-.15.

(n) Basis of Property to Subchapter K Entity - See Rule 810-3-6-.03.

(o) Basis of Interest in a Subchapter K Entity - See Rule 810-3-6-.03.

(p) Basis of Property Distributed by a Subchapter K Entity - See Rule 810-3-6-.03.

(q) Basis of Property - Individuals Establishing Alabama Domicile - See Rule 810-3-6-.16.

(r) Allocation of Basis - See Rule 810-3-6-.17.

Author: Ed Cutter, CPA  
Authority: Sections 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975  
History: Adopted through APA September 30, 1982.  
Amended July 27, 1998.  
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-6-.03 Basis in Subchapter K Entity.

(1) For all taxable years with respect to which a preliminary assessment of income tax could be made under the provisions of §40-2A-7, Code of Alabama 1975, as of May 27, 1997, and thereafter:

(a) Basis of property to subchapter K entity - A subchapter K entity's basis in property contributed to it under §40-18-8(o), Code of Alabama 1975, by a partner or member shall be determined according to 26 U.S.C. § 723.

(b) Basis of interest in subchapter K entity -

1. A contributing partner's or member's initial basis in a subchapter K entity interest acquired by a contribution of property (including money as described in §40-18-8[o]) to the subchapter K entity shall be determined according to 26 U.S.C. § 722.

2. Increases and decreases to the initial basis determined under paragraph 1 shall be made according to 26 U.S.C. § 705, and those adjustments to the initial basis shall be determined without regard to the allocation and apportionment rules of Section 40-18-22.

3. Special basis adjustments - The basis of the property of the subchapter K entity shall be determined according to 26 U.S.C. §§ 734 and 743, if the subchapter K entity has in effect an election under 26 U.S.C. § 754 (relating to optional adjustment to basis of partnership property).

(c) Basis of property distributed by subchapter K entity - The basis of property (other than money) distributed by a subchapter K entity to a partner or member other than in liquidation of the partner's or member's interest shall be determined according to 26 U.S.C. §732.

(2) No refunds shall be due or issued by reason of this regulation with respect to taxable years beginning before January 1, 1997.

(3) For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ann Fondren Winborne, CPA, Nancy D. Hatfield.

Authority: §§40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975.

History: New rule filed March 26, 1998, effective date April 30, 1998.

Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-6-.04 Basis of Property Acquired by Gift or Transfer in Trust.

(1) **Property Acquired After December 31, 1997.** The basis of property acquired by gift or by a transfer in trust shall be determined according to 26 U.S.C. §1015. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) **Property Acquired After March 14, 1985, but before January 1, 1998.** The basis shall be the same as the basis would be in the hands of the donor or the last preceding owner from whom the property was not acquired by gift; except that if such basis is greater than the fair market value of the property then for the purpose of determining the amount of loss the basis shall be the fair market value.

(a) **Donor's Basis Unknown.** If the basis of the property acquired by gift or transfer in trust after March 14, 1985, is unknown to the donee, the Department will attempt to obtain such facts as to determine the basis in the hands of the donor or the last owner who did not receive the property by gift or a transfer in trust. If the Department is unable to obtain such facts, the basis of the property will be determined, according to the best information available to the Department, to be the fair market value of the property at the time acquired by the donor or last preceding owner.

(b) **Transfer in Trust Other Than Gift, Bequest, or Devise.** If the property was acquired by a transfer in trust, other than a transfer in trust by a gift, bequest or devise, the basis shall be the same as in the hands of the grantor, increased by the amount of gain (or decreased by the amount of loss) recognized by the grantor on such transfer of the property.

(3) **Property acquired after December 31, 1932, but prior to March 15, 1985.** The basis shall be the fair market value of the property at the date of acquisition.

(4) **Property acquired prior to January 1, 1933.** The basis shall be the fair market value at the close of December 31, 1932.

Author: Lloyd B. Byrd, Judy A. Robbins.

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975.

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.05 Property Transmitted at Death.

(1) After December 31, 1997: The basis of property acquired from a decedent will be determined according to 26 U.S.C. §1014. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Prior to January 1, 1998: Basis for the following shall be the fair market value of the property at the time of decedent's death:

(a) Personal property acquired by specific bequest,

(b) Real property acquired by general or specific devise or by intestacy,

(c) Property acquired by the decedent's estate from the decedent.

(d) In all other cases of property acquired by will or intestacy, basis shall be the fair and reasonable market value of the property at the time of distribution to the taxpayer.

(e) The value of property as of the date of the decedent's death as appraised for the purpose of the federal estate tax or the alternate value as appraised for such purpose, whichever is applicable, shall be deemed to be its fair market value.

Authors: Lloyd B. Byrd, Judy A. Robbins.

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975.

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.06 Basis of Property Acquired Upon Like-Kind Exchange.

(1) **After December 31, 1984:** The basis of property acquired in a like-kind exchange shall be determined according to 26 U.S. C. §1031. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) **Prior to January 1, 1985:** The basis of property acquired in a like-kind exchange is the same as that of the property exchanged less the amount of money and the fair market value of other property received, less any loss (or plus any gain) recognized on the exchange.

(a) Corporate Stock. This rule does not apply in case of property received by a corporation in whole or in part in exchange for the stock or securities of that corporation.

(b) Mixed Exchanges. If the property acquired consisted of both like and unlike property, the basis shall be allocated between the properties (other than money) received, and for the purpose of allocation there shall be assigned to the unlike property an amount equal to its fair market value at the date of the exchange.

Authors: Lloyd B. Byrd, Judy A. Robbins.

Authority: §§ 40-2a-7(a)(5) and 40-18-6, Code of Alabama 1975.

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.07 Basis of Property Transferred to a Corporation.

(1) For tax periods beginning after December 31, 1984:

(a) the basis of property received by a distributee in a transaction described in subsection (e) or (f) of § 40-18-8, Code of Alabama, 1975 shall be determined in accordance with 26 U.S.C. § 358. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(b) the basis of property acquired by a corporation in a transaction described in subsection (e) or (f) of § 40-18-8, shall be determined in accordance with 26 U.S.C. § 362. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(c) Transactions described in subsection (e) or (f) of § 40-18-8 are those transactions meeting the requirements of 26 U.S.C. § 351, where property is transferred to a corporation controlled by the transferor, or those reorganizations as defined by 26 U.S.C. § 368.

(2) Transfers to corporation where control of property remains in same person - prior to January 1, 1985. Property transferred to a corporation in connection with a reorganization as defined in § 40-18-8(f) after December 31, 1932, but before January 1, 1985, where control as defined in 26 U.S.C. § 368(c) remains with the transferor, shall have the same basis as it would have in the hands of the transferor together with gain or loss recognized to the transferor on the transfer. This rule does not apply if the property acquired consists of stock or securities in a corporation, a party to the reorganization, unless the consideration in whole or in part is the stock or securities of the corporation acquiring the property.

Author: Ed Cutter, CPA  
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975  
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.08 Basis of Property Acquired on Liquidation of a Subsidiary.

(1) Basis of Property Acquired on Liquidation of Subsidiary. The basis of property acquired by a corporation as a result of a liquidation of a subsidiary to which § 40-18-8(h), Code of Alabama 1975, applies shall be determined in accordance with 26 U.S.C. § 334(b). For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) § 40-18-8(h) concerns the complete liquidation of subsidiaries satisfying the requirements of 26 U.S.C. § 332.

Author: Ed Cutter, CPA

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.09 Basis of Property of a Subsidiary after Acquisition. If an election under 26 U.S.C. § 338 is in effect for federal income tax purposes, the basis of property owned by a corporation shall be determined under 26 U.S.C. § 338 relating to the treatment of certain stock purchases as asset acquisitions. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.10 Basis of Property Received in Liquidation in Which Gain or Loss is Recognized. If property is received in a distribution in complete liquidation in which a gain or loss is recognized on receipt of the property, the basis of the property received shall be determined in accordance with 26 U.S.C. § 334(a). For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.11 Basis of Stock After Stock Dividend. The basis of stock with respect to which a corporation makes a distribution of its stock and the basis of the stock distributed shall be determined in accordance with 26 U.S.C. § 307. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.12 Basis of Property Acquired in Connection with an Involuntary Conversion.

(1) After December 31, 1984. The basis of property acquired in connection with an involuntary conversion in which a gain or loss was not recognized shall be determined according to 26 U.S.C. §1033. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Prior to January 1, 1985. The basis of property acquired in connection with an involuntary conversion (as described in §40-18-8(f), Code of Alabama 1975, in effect prior to January 1, 1985) shall be the same as the property converted, less the amount of money received but not expended by the taxpayer, increased by any recognized gain or decreased by any recognized loss upon the conversion.

Author: Judy A. Robbins.

Authority: §§ 40-2A-7(a(5)) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.13 Basis of Property Acquired before January 1, 1933. If property was acquired prior to January 1, 1933, the basis for determination of gain, loss, depreciation or depletion is the fair market value on January 1, 1933.

Author: Ed Cutter

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.14 Basis of Property Acquired from a Spouse or Former Spouse.

(1) The basis of property received from a spouse or former spouse in a transaction in which a gain or loss was determined under § 40-18-8(m), Code of Alabama 1975, shall be determined in accordance with 26 U.S.C. § 1041. For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

(2) Section 40-18-8(m) concerns the transfer of property to a spouse or former spouse.

Author: Ed Cutter, CPA

Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975

History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.15 Basis of Replacement Property in Sale of Stock to an Employee Stock Ownership Plan or Cooperative. If securities are sold to an employee stock ownership plan or an eligible work-owned cooperative, and gain was not recognized pursuant to § 40-18-8(n), Code of Alabama 1975, the basis of the qualified replacement property, as defined by 26 U.S.C. § 1042, shall be determined in accordance with 26 U.S.C. § 1042(d). For interpretation of federal statutes adopted by the Alabama Legislature see Rule 810-3-1.1-.01, Operating Rules.

Author: Ed Cutter, CPA  
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975  
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.16 Basis of Property of Individuals Establishing Alabama Domicile.

(1) Effective for tax years beginning after December 31, 1997, the basis of both real and personal property owned by an individual on the date Alabama domicile is established shall be the same basis as is used for federal income tax purposes on that date.

(2) Example 1: Taxpayer owns an IRA for which all contributions made were deducted from the taxpayer's income for federal income tax purposes. The taxpayer establishes Alabama domicile on January 1, 1998. The basis for the IRA for Alabama income tax purposes is zero, upon the establishment of Alabama domicile.

(3) Example 2: Taxpayer owns a truck with an original cost of \$100,000 and an adjusted basis of \$80,000 as of December 31, 1997. On January 1, 1998, the taxpayer establishes Alabama domicile. The adjusted basis in the truck for Alabama income tax purposes is \$80,000, upon the establishment of Alabama domicile.

Author: Ed Cutter, CPA  
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975  
History: New rule filed April 28, 1999, effective June 2, 1999.

810-3-6-.17 Allocation of Basis. Effective for tax years beginning after December 31, 1997, if property is acquired in an applicable asset acquisition as defined by 26 U.S.C. § 1060, the basis of the acquired property shall be determined in accordance with 26 U.S.C. § 1060. Federal regulations and determinations for 26 U.S.C. § 1060 will be followed in the administration of this section.

Author: Ed Cutter, CPA  
Authority: §§ 40-2A-7(a)(5) and 40-18-6, Code of Alabama 1975  
History: New rule filed April 28, 1999, effective June 2, 1999.